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POSTAL REGULATORY COMMISSION
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Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products	Docket No. RM2017-3

INITIAL COMMENTS OF THE PUBLIC REPRESENTATIVE

March 1, 2018

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I. INTRODUCTION

On December 1, 2017, the Commission established this docket to consider changes to the regulatory system governing market dominant products.[1] That regulatory system was adopted by the Postal Accountability and Enhancement Act (PAEA). The changes proposed by Order No. 4258 grow out of the Commission's finding that the existing system "as a whole has not achieved the objectives of the PAEA."[2]

Pursuant to Order No. 4258, the Public Representative hereby files his comments.[3] Submitted with these comments are the sworn declarations of Dr. John Kwoka, Dr. Robert W. Wilson,[4] Dr. Timothy J. Brennan,[5] and Dr. Lyudmila Bzhilyanskaya.[6]

Unlike those who crafted the PAEA, the Commission has the advantage of hindsight. With hindsight, it is clear that fundamental assumptions underlying the PAEA were incorrect. Among the erroneous assumptions was a fundamental assumption that

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[1] Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (Order No. 4258 or NOPR). In its notice, the Commission designated the undersigned to serve as Public Representative. Order No. 4258 at 131.

[2] Order No. 4257, Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017, at 275 (Order No. 4257).

[3] Assisting the Public Representative are Kenneth E. Richardson and Samuel M. Poole from the Office of General Counsel and Dr. Lyudmila Bzhilyanskaya from the Office of Accountability and Compliance.

[4] Declaration of John Kwoka and Robert Wilson, March 1, 2018 (Kwoka/Wilson Decl.). Dr. Kwoka is currently the Neal F. Finnegan Distinguished Professor of Economics at Northeastern University. Dr. Wilson is a consulting economist and formerly a principal at The Brattle Group.

[5] Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018 (Brennan Supp. Decl.). Dr. Brennan is currently Professor of Public Policy and Economics in the School of Public Policy at the University of Maryland, Baltimore County.

[6] Supplemental Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 1, 2018 (Bzhilyanskaya Supp. Decl.). Dr. Bzhilyanskaya is a Senior Econometrician in the Commission's Office of Accountability and Compliance.

anticipated declines in mail volume would be gradual enough to permit the Postal Service to adapt its operations in an organized manner. That assumption proved to be overly optimistic. Within 2 years of the PAEA's enactment, the Great Recession precipitated steep declines in mail volume that produced a "new normal" postal environment.[7] Since the end of the Great Recession, mail volumes have continued to decline, including declines in the volume of First-Class Mail, the Postal Service's most profitable class of mail.

Based upon the assumption that mail volumes would decline more gradually, the Postal Service was expected to be able to generate sufficient revenue to prefund a substantial portion of retiree health benefits; to produce retained earnings that would support needed investments; and to meet all remaining financial obligations.[8] None of those expectations has been realized.

The Internet was, of course, a principal cause of declining mail volume and the loss of revenue. Today, the Internet continues to drive reductions in mail volume as consumer preferences continue to evolve. At the same time, shopping on the Internet has created demand for more labor intensive and less profitable package delivery services. The result is a market for postal services in 2018 that is significantly different from the market in 2007.

In this proceeding, the Commission has the opportunity to address shortcomings of the original PAEA price cap system for market dominant products. In Order No. 4257, the Commission correctly concluded that the current system is not achieving the statutory objective of financial stability and the generation of retained earnings that are fundamental to the achievement of other statutory objectives. The Public

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[7] *See* Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013, at 83-94 (Order No. 1926).

[8] S. Rep. No. 108-318, 108th Cong., 2d Sess. (Aug. 25, 2004) at 8.

Representative supports the Commission's conclusion that steps need to be taken to improve the Postal Service's financial situation.

The Public Representative makes four recommendations regarding the existing price cap system. The recommended changes are based upon price cap principles discussed in the Public Representative's previous comments in this proceeding.[9]

II. EXECUTIVE SUMMARY

These Comments focus on the critical problem facing the Postal Service—financial instability and the means and methods to alleviate that instability. Consequently, these Comments do not cover other issues discussed in Order No.4258.

First, in Part III below, the Public Representative's Comments explain the several deficiencies of Order No. 4258 that will prevent achievement of the Commission's stated goal to place the Postal Service on the path toward financial stability. When fashioning rules to move the Postal Service's finances toward financial stability, the Commission is required to implement rules having a reasonable basis in the record. Also, extensive case law demonstrates new rules must not be either arbitrary or capricious. As prescribed, the rules in Order No. 4258 do not appear to meet those standards.

Following are the deficiencies of Order No. 4258, and Order No. 4257 where relevant.

- The finding that the Postal Service is achieving short-term financial stability is contrary to fact and law.

[9] Comments of the Public Representative, March 21, 2017 (PR 2017 Comments). The Public Representative's comments were filed in response to a December 20, 2016 Advance Notice of Proposed Rulemaking (ANOPR). Accompanying the Public Representative's comments were the sworn declarations of Dr. John Kwoka, Dr. Timothy J. Brennan, and Dr. Lyudmila Y. Bzhilyanskaya. Declaration of John Kwoka, March 20, 2017 (Kwoka Decl.); Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017 (Brennan 2017 Decl.); and Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 20, 2017 (Bzhilyanskaya 2017 Decl.).

- The order fails to establish and apply underlying principles on which to base the increased price cap authority as presented in the Declaration of Dr. Kwoka and Dr. Wilson. They argue the principle that costs beyond the control of management must be included in the price cap as a separate “Z factor.”
- The proposed 5 years of 2 percent supplemental rate authority is not supported adequately and is not based upon reasonable consideration of all relevant factors and will not place the Postal Service on the path to financial stability.
- The rate requirements of 2 percent for non-compensatory classes and products are not supported adequately, may be beyond the Commission’s authority to order, and will have little effect in moving the Postal Service toward break even for those services.
- The rate allowance totaling 1 percent for incentives to maintain operational efficiency and performance standards is without reasonable foundation. It rewards the Postal Service for continuing a level of efficiency growth that the Commission has found does not meet Objective I, improperly expects efficiency growth to offset volume demand declines, and offers a rate increase percentage that is too little to incentivize the Postal Service or to assist in improving financial stability.

In addition, in Part IV below, other adjustments to Order No. 4258 are discussed.

- Due to the Postal Service’s financial instability, rate relief must be provided earlier than the proposed rules appear to permit.
- Delay of the next system review for five years is too long.

In Part V below, the Public Representative's recommendations for price cap adjustment are designed to allow the Postal service to return to financial stability as contemplated by Objective 5 of the PAEA.

- Retain the price cap and make principled adjustments that protect against undermining price cap principles by addressing causes, not symptoms, of the Postal Service's financial difficulties and by reflecting economic factors beyond the Postal Service's control that cause its costs to change.
- Adjust the price cap for the exogenous factors of uncontrollable retiree health benefit costs, and OPM's actuarial changes to CSRS and FERS unfunded pension liability costs.
- Include an additional exogenous factor adjustment to the price cap formula to reflect declining demand. Alternatively, institute a public inquiry to investigate a declining demand adjustment for possible implementation as part of the next market dominant system review.
- Continue to press the Postal Service to raise rates for Marketing Mail Flats to compensatory levels within the additional price cap authority created by exogenous factor adjustments to the class-level price cap for Marketing Mail.
- Phase-in adjustments to the price cap applicable to the Periodicals Class in order to provide the Postal Service with opportunities to raise rates to compensatory levels and thereby permit the recovery of total costs.
- Shorten the period before the next system review to 3 years.

III. DEFICIENCIES OF ORDER No. 4258 DESIGNED FOR ACHIEVING FINANCIAL STABILITY

This section focuses upon the deficiencies of the Commission's proposed rules intended to implement its determinations regarding the PAEA objective to maintain financial stability of the Postal Service by assuring adequate revenues, including retained earnings, as well as maximizing efficiency and maintaining a high level of service standards. 39 U.S.C. § 3622(5), (1) and (3).

With these proposed rules, for the first time, the Commission offers the Postal Service rate cap relief from the bounds of the CPI-U and the rigid limitations of the exigency clause. Initially, this relief seems to be consistent with the Public Representative's recommendations in this proceeding for a reset adjustment of rates to recover revenue to catch-up with the Postal Service's annual costs that have consistently exceeded revenue over the eleven-plus years under the PAEA as well as attempt to raise further the price cap on the non-compensatory classes and products.

The proposed relief in Order No. 4258 would allow market dominant rates to rise in equal percentage increments over five years by an amount equal to what the Commission claims equates to the net present value of the FY 2017 loss of $2.7 billion. NOPR at 38. As icing on the cake, so to speak, there is the additional opportunity to increase the price cap by 1 percent annually if the Postal Service maintains consistent efficiency gains of at least 0.6 percent averaged over 5 years, and if it maintains service standards by class. It additionally grants a 2 percent rate allowance for any non-compensatory class of mail, *i.e.*, Periodicals and requires non-compensatory products to be increased by 2 percent in addition to all other rate allowances when a rate case is filed.

In reality, the proposed attempt to reset rates and other adjustments are an assortment of *ad hoc* tweaks that fall far short of the recommendations of Dr. Kwoka and Dr. Brennan offered with the Public Representative's initial Comments in this proceeding. For one, the apparent reset of rates to recover revenue equivalent to the level of the FY 2017 losses is an inadequate reset without underlying principle. Dr. Kwoka discussed the necessity that a price cap regime permit recovery of exogenous costs as well as other costs, both at the outset and on reset upon review after a reasonable period. Dr. Brennan explained the need to eliminate the negative effects of falling demand on the price cap and presented a formula to net out falling demand.

A. The Commission's Authority and Obligation to Provide a Reasoned Basis and Purpose for the Rules

Having determined the Postal Service is not achieving financial stability, the Commission has some latitude, but not unfettered authority, to fashion new rules for adjusting the price cap. Rules designed to achieve the PAEA objectives of financial stability and other objectives and factors must be grounded upon reasonable support.

In Order No. 4258, the Commission proposes to amend the price cap to allow the Postal Service three percent additional rate authority. The Order has two distinct analytical parts. First, it interprets §3622 of title 39 to provide broad authority to modify or replace the market dominant ratemaking system. Order No. 4258 at 14-25. Second, it proposes to make regulatory changes, including the aforementioned rate adjustment. *Id.* at 39-72. In other words, the first part of Order No. 4258 interprets the Commission's authority and the second part implements it. These two parts require separate legal analyses.

The Commission's interpretation of § 3622 should be considered in light of *Chevron, U.S.A., Inc. v. Natural Res. Def. Council,* 467 U.S. 837 (1984) because the Commission is interpreting "the statute which it administers." *Id.* at 842; *see e.g., USPS v. Postal Regulatory Comm'n,* 640 F.3d 1263, 1266 (D.C. Cir. 2011). The *Chevron* case created a two-step test for judicial review in such a circumstance. Under step one, if "Congress has directly spoken to the precise question at issue…that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-843. Under step two, "if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843.

In Order No. 4258 the Commission determined that the plain language of § 3622 grants "broad authority to either modify or replace the existing market dominant ratemaking system." Order No. 4258 at 25. This is a finding that the section unambiguously expresses Congress's intent under prong one of the *Chevron* test. Notably, the Commission did not interpret the statute as ambiguous as an alternative basis for its Order. Such an interpretation would be due so-called *Chevron* deference under the second prong of the test.

The Public Representative endorses the Commission's conclusion that it has broad authority to modify or replace the ratemaking system for market dominant products. The Public Representative believes that the Commission has adequately explained its reasoning and accurately assessed its authority to alter the market dominant ratemaking system.

However, the Public Representative cannot express this same confidence for the second part of Order No. 4258. Unlike the extensive analysis of the Commission's authority under § 3622, the Commission's explanations of its decisions to provide a total of 3 percent in additional rate allowances for all classes plus an additional 2 percent for the Periodicals class s inadequate, as explained in this section.

On appeal, the Commission's decision would be reviewed under the Administrative Procedure Act (APA), 5 U.S.C. §§ 701 *et seq.,* to determine whether the decision was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A); *see also* 39 U.S.C. § 3663 (incorporating APA review standard). To satisfy this standard, an agency must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines v. United States,* 371 U.S. 156, 168 (1962)). A reviewing court would "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park v. Volpe,* 401 U.S. 402, 414 (1971); *Bowman Transp. Inc. v. Arkansas-Best Freight System,* 419 U.S. 281, 285 (1974). "Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, has failed entirely to consider an important aspect of the problem, has offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. The APA "establishes a scheme of 'reasoned decision-making'" and requires that agency processes must be "logical and rational." *Allentown Mack Sales & Serv., Inc. v. N.L.R.B.*, 522 U.S. 359, 374 (1998) (internal citation omitted). "Put simply, the APA requires that an agency's exercise of its statutory authority be reasonable and reasonably explained." *Manufacturers Ry. Co. v. Surface Transp. Bd.,* 676 F.3d 1094, 1096 (D.C. Cir. 2012).

As some observers have noted, this standard has become more stringent over time. 1 Richard J. Pierce Jr., *Administrative Law Treatise*, § 7.1 at 558-560 (2010) (Pierce). Indeed, "[j]udicial interpretation of the malleable language of the APA has produced changes in rulemaking procedure that could be characterized as revolutionary if they had been affected in a day for a year rather than gradually over a period of decades." *Id.* at 559. Under the modern application of this standard, "[i]n order to avoid the risk of judicial reversal of a rule as arbitrary or capricious, an agency must respond to all major points made in comments, state the factual predicates for its rule, support the factual predicates by linking them to something in the record of the rulemaking, explain its reasoning for resolving the issues as it did, relate its findings and its reasoning to decisional factors made relevant by its statute, and give reasons for rejecting plausible alternatives to the rule it adopted." *Id.*

As explained below, the Commission's order cannot sustain its rulemaking in this case as it stands. Order No. 4258 explains the Commission's methodology for granting 2 percent in supplemental rate authority. Order No. 4258 at 37-41. In the order, the Commission uses the Postal Service's FY 2017 net loss of $2.7 billion as "reference point" for the Postal Service's financial position but acknowledges that "additional considerations" such as inflation, the cost of inputs, changes in operational efficiency, secular volume trends, and customer response to price changes will affect the Postal Service's finances. *Id*. at 38, 41. The Commission concludes that, "it is not possible to precisely calculate" the additional rate authority required to address these factors but that, regardless, "[s]uch precision is not necessary." *Id.* The Commission then proceeds with its analysis, discarding the additional factors that it noted and employing the FY 2017 loss of $2.7 billion as its target for returning the Postal Service to financial stability.

B. Contrary to Order No. 4257, the Postal Service Is Not Achieving Short-Term Financial Stability

In a motion filed January 5, 2018, the Public Representative requested the Commission to reconsider its determination in Order No. 4257 that the market dominant system has allowed the Postal Service to maintain short-term financial stability.[10] On February 6, 2018, the Commission denied the Public Representative's motion on the grounds that the Public Representative had failed, "to allege errors of fact or law sufficient to merit reconsideration…."[11] In Order No. 4398, the Commission stated that the Public Representative would have the opportunity to raise issues of fact or law

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[10] Motion of the Public Representative for Reconsideration, January 5, 2017 (PR Motion).

[11] Order Denying Motion for Reconsideration, February 6, 2018, at 8 (Order No. 4398).

regarding the Commission's analysis of short-term financial stability to the extent they relate to the Commission's proposal in the NOPR. *Id.* at 9.

In denying the Public Representative's motion for reconsideration, the Commission asserts that it has the discretion to decide how to measure short-term financial stability. Order No. 4398 at 9. The Public Representative does not contest the Commission's authority to determine the method of measurement. In previously filed comments, the Public Representative acknowledged that the phrase "to maintain financial stability" is, on its face, ambiguous. Under the step-two analysis of *Chevron, supra,* agencies may exercise discretion in resolving such ambiguities, but are not free to abuse their discretion. In this case, the Commission has abused its discretion.

The Commission's conclusion in Order No. 4398 that "the current system has allowed the Postal Service to maintain short-term financial stability" is based on a finding that "the Postal Service was able… to maintain a positive adjusted operating profit…to operate continuously without interruption." *Id.* at 164-165. The Commission's finding lacks adequate factual and legal support.

The assessment of financial stability, whether short-term, medium-term, or long-term, is conducted under Objective 5. Objective 5 is not limited to consideration of "positive adjusted operating profit" or to the ability "to operate continuously without interruption."

Indeed, the Commission's concept of "positive adjusted operating profit" is more akin to the Postal Service's annual calculation of 'controllable (loss) income' which is used to provide insights into how the Postal Service has done containing costs within its control in the day-to-day operations of its business, not its financial stability. The Postal Service has candidly admitted that controllable costs is a "non-GAAP" measure (*i.e.,* an accounting principle not generally accepted in the United States) and that "controllable (loss) income" should not be considered a substitute for net (loss) income and other GAAP reporting measures. *See, e.g.,* FY 2017 Form 10-K at 17.

In addition, the concept of "positive adjusted operating profit" relied upon by the Commission in assessing short-term financial stability depends, in part, upon end-of-year cash reserves that the Commission acknowledges have accrued because of the Postal Service's limiting of its capital investment and its nonpayment of statutory employee benefit payment obligations. Order No. 4257 at 163-164. In other words, the Postal Service's ability to maintain a level of cash sufficient to maintain operations in the short-term is due to its ability to avoid meeting other obligations, including statutory obligations.

There has been no demonstration that Objective 5 contemplates reliance upon inadequate investment and defaulted legal obligations as a basis for achieving financial stability. That proposition is contradicted by one of the PAEA's central purposes; namely, that the Postal Service should operate like a private commercial enterprise using best business practices.[12] Private enterprises do not, and cannot, claim short-term financial stability by defaulting on their obligations or by deferring investments that are critical to their near-term continued operation.

Finally, the Commission's finding of short-term financial stability is contradicted by its own discussion of three financial ratios: the Postal Service's working capital, its capital expenditure ratio, and its debt ratio. Order No. 4257 at 172-174. That discussion is inconsistent with, and completely undercuts, the bases for the finding of short-term financial stability.[13]

[12] *See* H.R. Rep. No. 66, 109th Cong., 1st Sess. (2005) at 43; S. Rep. No. 318, 108th Cong., 2nd Sess. (2004) at 49; The Presidential Commission on the U.S. Postal Service, Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service, July 31, 2003, at 18, 21, 36.

[13] The Commission attempts to minimize the adverse impact of those ratios on its finding of short-term financial stability by stating that it does not rely upon them and that because the Postal Service differs from private sector companies, standard financial measurements reflected in the ratios may not be directly applicable. Even a cursory review of those ratios makes clear why the Commission does not rely upon them.

Working capital “measures how well the Postal Service can meet its short-term obligations using current assets.” *Id.* at 172. The Commission acknowledges that, “the Postal Service has not had any working capital for the entire PAEA era.” *Id.* at 173. The capital expenditure ratio shows “that in FY 2007, the Postal Service invested approximately 4 percent of revenue on capital outlays, but by FY 2016 the amount invested had dropped to 2 percent.” *Id.* at 174. Analysis of the Postal Service’s debt ratio shows “a steady increase…since FY 2007, which indicates…that the Postal Service does not possess sufficient assets to meet its financial obligations.” *Id.* at 175.

The Commission’s ruling on the achievement of short-term financial stability does not affect the Commission’s broader determination that the market dominant system had failed to achieve the Objective 5 goal of “adequate revenues, including retained earnings, to maintain financial stability.” Order No. 4257 at 178. However, the ruling on short-term financial stability significantly affects the magnitude and timing of the remedies proposed in the NOPR and the implementation dates of the rules resulting from this review.

Upon reviewing the Commission’s recent analysis and proposed remedy, Dr. Kwoka and Dr. Wilson have concluded, “The problems facing the Postal Service are immediate and substantial, not limited to the medium and longer term. There problems require measures that go beyond those in the Order in both time and magnitude.” Kwoka/Wilson at 5. As discussed below, the amount of supplemental rate authority and its extended phased-in implementation will deny the Postal Service revenues needed as soon as reasonably possible in the short-term. The remedy gives the Postal Service too little, too late. Neither will the proposed *performance-based* rate authority generate sufficiently significant revenues in the short-term to meet the Postal Service’s needs. *See infra, S*ection IV.A.

If there is any doubt about the Postal Service's need for additional short-term revenue, that doubt is removed by the Postal Service's recent decision at the end of FY 2017 to default on four obligations to the U.S. Treasury:

- It defaulted on its payment to the Postal Service Retiree Health Benefit Fund (PSRHBF) for unfunded liabilities;
- It defaulted on its payment into the PSRHBF for normal cost payments;
- It defaulted on its payment for unfunded CSRS benefits; and
- It defaulted on its payment for unfunded FERS benefits.[14]

The Postal Service stated that those defaults totaling $6.9 billion were necessary in order to generate cash for necessary investments, to support its operations, and to prepare for unexpected contingencies. FY 2017 Form 10-K at 36.

The Public Representative submits that the Commission's conclusion that the Postal Service has achieved short-term financial stability is legally flawed, factually unsupported, unreasonable, and irrational. *See California v. Watt,* 712 F.2d 584, 595-597 (D.C. Cir. 1983). A finding of short-term financial stability cannot be rationally based on the Postal Services short-term inability to pay its bills. The Postal Service is clearly facing short-term financial instability. As the Commission has acknowledged, the three tiers of financial stability (short-term, medium-term, and long-term) build upon each other. Order No. 4257 at 159. The Postal Service's short-term financial instability must be addressed promptly. Correction for this short-term instability lies in providing more immediate relief than offered by the rules proposed in Order No. 4258.

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[14] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 of the Fiscal Year Ended September 30, 2017, at 5-6 (FY 2017 Form 10-K). By not making these payments, the Postal Service has effectively used these employee benefit funds as a *de facto* source of borrowing in lieu of its now exhausted $15 billion revolving line of credit with the U.S. Treasury.

C. The Method for Assessing and Achieving Financial Stability is Inadequate Because the Proposed Price Cap Adjustments are Not Forged with Underlying Principles and Will Not Recover Medium and Long-Term Costs as Anticipated

1. Underlying Principles for Rate Adjustments Have Not Been Established

Of primary concern to the Public Representative is the fundamental lack of any analytical framework that utilizes economic principles to support the Commission's determination to modify the price cap with a 2 percent annual supplemental rate authority. While the proposed rules appear specific, the proposed rules presented in Order No 4258 do not rest upon appropriate principles and rely upon an insufficient conceptual framework. Also, the supporting detail necessary to demonstrate reasoned decision-making grounded upon any economic or other rational principle is inadequate. To survive review, the Commission must provide "a rational connection between the facts found and the choice made." *Burlington,* 371 U.S. at 168. In other words, the Commission's rulemaking must be anchored in a logical analytical framework to avoid being overturned as arbitrary and capricious under APA review. Additional and substantial work is necessary to bolster the final rulemaking order.

The Commission explains that it intends the rules to place the Postal Service on the path toward the objective of financial stability. Order No. 4258 at 37. Without a more principled framework providing for appropriate adjustments along the way, the path in Order No. 4258 meanders without destination rather than pointing toward the objective of financial stability.

The Declaration of Dr. Kwoka submitted with the Public Representative's initial comments, and the additional Declaration submitted with these Comments by Dr. Kwoka and Dr. Wilson forcefully argue that price cap adjustments should be based upon guiding principles of price caps. *See e.g.,* Kwoka/Wilson Decl. at 5. The legislative history of the PAEA consists of testimony during the McHugh Oversight

Hearings where six witnesses including Dr. Kwoka testified on the principles of price-cap regulation as well as related policy questions and practical considerations for postal regulation.[15] In their Declaration, they contend that the price cap should take into account exogenous factors outside management's control. The principle will permit a continuing opportunity for further adjustments to the price cap, rather than a cost of service type of reset deferred over a period of five years proposed in Order No. 4258.

Dr. Kwoka and Dr. Wilson, "do not see that [Order No. 4258] explicitly identifies or addresses the exogenous costs that the Postal Service must cover." Kwoka/Wilson Decl. at 12. Unfortunately, in the 275 pages of Order No. 4257 and 131 pages of Order No. 4258, the very detailed recommendations of Dr. Kwoka, who has over 30 years of practical and theoretical experience with price cap regulation as well the presentation of Congressional testimony about formulating price caps, there is no mention of his recommendation to recognize exogenous costs in the price cap. It appears the Commission never considered his recommendations. As noted above, "[i]n order to avoid the risk of judicial reversal of a rule as arbitrary or capricious, an agency must respond to all major points made in comments." Pierce at 559.

In addition, Dr. Brennan's Declaration stated that the price cap should factor in the continuing systemic volume declines to allow the Postal Service to make reasoned strides toward financial stability. Brennan Decl. at 13-15. These objective measures apply the principle that certain costs and volume levels are outside management's control and, when incorporated into the price cap to maintain net revenue neutrality, will provide management a reasonable opportunity to achieve financial stability. Neither the NOPR nor Order No. 4257 considered his presentation.

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[15] *See Hearing Before the Subcomm. on the Postal Service of the H. Comm. on Government Oversight and Reform,* 105th Cong. 33-51 (April 16, 1997) (Kwoka Congressional Testimony). Dr. Kwoka had been a member of the FCC team that drafted the AT&T price-cap regulation.

The solutions proffered by Drs. Kwoka, Wilson, and Brennan provide an analytical framework upon which supplemental rate authority can be grounded. The Public Representative believes that these approaches are "logical and rational" because they are based on existing components of price cap theory. *Allentown*, 522 U.S. at 374. The Commission's order, on the other hand, does not "articulate a satisfactory explanation for its action" because it departs from the existing regulatory framework without explanation

The arguments favoring the objective approach recognizing exogenous costs and volume declines are detailed in Part V, below.

2. Supplemental Rate Authority--the 5 years of 2 percent Supplemental Rate Authority is Unsupported and Not Based upon Reasonable Consideration of All Relevant Factors

In addition to the CPI-U price cap adjustments currently provided by the PAEA, the NOPR would allow up to a 2 percent supplemental rate authority per annum to the price cap for five years, after which the allowance will be terminated. NOPR, Attachment A at 22. This supplemental rate authority addresses "the medium-term tier of the financial stability test." NOPR at 39. The Commission has defined medium-term financial stability as, "Medium-term financial stability requires total revenue to cover total cost, both attributable and institutional." Order No. 4257 at 248; *see also* 165-166. From this, "Adequate revenues build up net income (which demonstrates medium-term financial stability) and over time should lead to retained earnings (which demonstrate long-term financial stability). Retained earnings may be used to fund capital investment which should lead to operational efficiency gains and help maintain high quality service standards." NOPR at 35-36.

Sufficient justification for the 2 percent supplemental allowance is absent from the order. The Order appears to state that the Commission's entire basis for the 2 percent supplemental rate allowance is to recover the Postal Service's $2.7 billion FY

2017 loss. It accomplishes this by allowing 5 years of 2 percent increases that, in net present value terms, is equivalent to a current one-time market dominant rate increase of 5.7 percent followed by 4 years of CPI-U increases. *Id.* at 38, 42. However, Order No. 4258 offers no calculation either in text or by library reference to support the net present value claim.[16] The order does not mention, estimate or explain the assumed discount rate and or other factors relevant to the calculation.[17]

Possibly, the 2 percent annual increase for five years is not intended to be derived solely from the FY 2017 loss although the "Commission uses the $2.7 billion FY 2017 net loss as its reference point." *Id.* at 38. If the Commission does not intend the 2 percent allowance to recover entirely the FY 2017 loss, then the basis for the 2 percent increase is wholly unexplained and unjustified. As long as elasticity is less than one, a rate increase anywhere less than 2 percent or, at least, slightly more than 2 percent above the CPI-U would increase revenue to alleviate Postal Service losses. Without a more principled approach or analysis of the choice, there is no demonstration that the increase of 2 percent per year is more reasonable than 3 percent, or any other number that is likely to increase revenues.

Dr. Kwoka and Dr. Wilson state that, "we find that the problems of the shorter term have not been properly assessed. Moreover, the *ad hoc* 2 percent annual price relief is mathematically unrelated to the underlying nature of the problem, particularly in light of o the problem of declining demand that causes increases in average cost." Kwoka/Wilson Decl. at 12.

The arbitrary and capricious standard requires that the Commission provide "a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43 (internal

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[16] The appropriate term is present value rather than net present value.

[17]. The only table offered with Order No. 4258 to estimate the total percentage increases in rates over 5 years fails to compound the 2 percent annual increases. PRC-LR-RM2017-3-2, Excel file worksheet "PCAutCalc."

citation omitted). In other words, the Commission's decision must be reasonable and reasonably explained. Here, the Commission's entire basis for its 2 percent supplemental authority adjustment is the Postal Service's loss in a single fiscal year. It dismissed several factors that could impact this number as unknowable and disregarded other factors, such as declining demand, the retiree prefunding costs, and the FY 2017 dip in worker's compensation numbers. It noted that the Postal Service's losses have been variable but did not elect to average losses from multiple years.

Assuming that an immediate 5.7 percent increase is equivalent to 2 percent increases over 5 years, the important question is whether additional revenue of $2.7 billion (or another amount) would be sufficient to reach medium-term financial stability. The Commission's solution is backward looking. Losses will not necessarily continue at the FY 2017 level. They are likely to increase. Even if rates eventually recover the equivalent of an immediate single 5.7 percent rate increase, by the fifth year, without the opportunity for adjustments due to exogenous cost changes for either OPM recalculations or volume losses, the Postal Service revenue will continue to be far below costs. Medium term financial stability will fail.

In essence, the proposed rule takes a snap shot of one year's loss as representing the Postal Service's losses for each of the next 5 years.[18] Dr. Kwoka and Dr. Wilson explain, "[t]his is an unfortunate choice since it is the lowest loss sustained by the Postal Service in the last 10 years. It does not correctly reflect either its longer term average loss or its likely future revenue shortfalls." Kwoka/Wilson at 12, s*ee* Order No. 4258 at 38, 40-41; Order No. 4257 at 168, Table II-10.

[18] Because of implementation delays, these 5 years of adjusted price cap rates will be effective through 7 years from the date of these comments. As proposed, the new authority will not likely become effective until spring of 2020. The fifth year of annual rate increases would then occur in spring of 2024 and the benefit of the full fifth year of rate increases will not be realized until spring of 2025, 8 years after the FY 2017 loss on which the entire adjustment is grounded.

The proposed rules do not call for a full reset of rates to cover costs as quickly as possible. Rather, rate increases will extend over several years and the phased-in rates certainly do not offer the Postal Service the opportunity for these “reset” rates to recover the target costs as they would if the entire adjustment were allowed immediately and included exogenous costs.

In sum, the Commission’s decision does not provide a “satisfactory explanation” for how it has determined that 2 percent is the appropriate amount of additional rate authority. *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. The Commission appears to base this determination on the Postal Service’s loss in a single fiscal year without explanation as to why other fiscal years were not considered. In the Public Representative’s view, such a basis is clearly arbitrary and capricious and would not survive review as “logical and rational.” *Allentown*, 522 U.S. at 374.

a. Commission Uses Constant Volumes without Elasticity Impact

The Commission developed future revenue estimates “by applying the future rate increases to current mail volumes.” Order No. 4258 at 42. The Commission does not provide its calculations with Order No. 4258. The Public Representative has estimated the additional revenues that could be collected over a 5-year period starting in January 2019: the very earliest, but unlikely, date when the Commission’s proposal might lead to increased rates.[19] In developing the estimates, the Public Representative followed the Commission’s methodology assuming the application of both supplemental rate authority and CPI-U rate authority. Significantly, the Commission assumes volumes

[19] As a practical matter, these new rules are likely be applied first to rates becoming effective in 2020.

will remain constant and assumes no impact of price elasticity on mail volumes [20] Table 1 estimates that the annualized additional revenue is generally consistent with the Commission's estimates in Order No. 4258.

[20] To make calculations relatively simple, the Public Representative used the FY 2017 total Market Dominant Mail volumes provided in the FY 2017 ACR. To develop a price for the base year (FY 2018), the Public Representative applied a CPI-U price increase to the current average revenue per piece of $0.318 for all Market Dominant Mail provided in the FY 2017 ACR. For each of five consequent years, the Public Representative compared two types of revenue estimates: with two rate authorities applied (2.05 percent of average CPI-U authority and 2 percent of supplemental rate authority) and with only the CPI-U rate authority applied. The difference between these two revenue estimates is the additional revenue that would result from the application of supplemental rate authority. The Public Representative estimated this additional revenue for a 5-year period and calculated a present value. Considering that supplemental rate authority would be available for 5 years, a relatively short period, the Public Representative applied a discount rate of 3 percent. For details, *see* Library Reference PR-LR-RM2017-3-1, file Supporting Calculations.xlsx, Worksheet "Suppl Auth Calc".

Table 1
Additional Revenue for Market Dominant Mail
Under the Commission's Proposal
($ billions, Present Value)

	Year 1	Year 2	Year 3	Year 4	Year 5	Over 5 years	Annualized
Additional Revenue	0.91	1.82	2.74	3.65	4.56	13.68	2.74

Source: Library Reference PR-LR-RM2017-3/1, file Supporting Calculations xlsx, Worksheet "Suppl Auth Calc".

b. Declining Volume Estimates

The Commission's assumption of constant volumes is problematic. The Commission has acknowledged in Order No. 4258 that due to the declining volume trends and the effects of price elasticity, revenue estimates will be lower than "the proposed rate adjustment authority would actually generate." Order No. 4258 at 42-43. The Public Representative's analysis of the historical data provided in the CRA reports annually show that during the PAEA era, the annual rate of volume decline for all Market Dominant Mail was 3.64 percent on average, but varied significantly in different years: from 0.3 percent in FY 2016 to 12.5 percent in FY 2009.[21] The decline in volumes was a result of different factors including, but not limited to, the annual CPI-U price increase, electronic diversion, the exigent price increase (effective for approximately 9 quarters in FY 2014 – FY 2016) and the Great Recession that hit the Postal Service in the early years of the PAEA. In FY 2017, the overall Market Dominant

[21] *See* PRC-LR-RM2017-3/1, worksheet "Figure II-16" and Docket No. ACR2017, Library Reference USPS-LR-FY17/1, file Public_Fy17CRAReport.xlsx, worksheet "Volume1".

Mail volumes declined by approximately 3.6 percent, and for FY 2018, the Postal Service's mail volume forecast estimates a similar decline.[22]

The Commission found in Order No. 1926 that the effect of the Great Recession on Market Dominant Mail volumes was over by FY 2012.[23] Consequently, to understand the magnitude of the mail volume decline in the 5-year period from FY 2019 through FY 2023, it is best to consider only volume trends since FY 2012. Using a decline of 2 percent would be conservative since it assumes a "status quo" situation when all current factors that affect volume decline would continue at the same or even slower pace, and there would not be any new factors accelerating such a decline. The Public Representative compared a 2 percent of volume decline with the revenue the Postal Service could receive for Market Dominant Mail under the Commission's *status-quo* approach. The estimated annualized amount of under-collected revenues under the Commission's proposal is $0.2 billion or approximately 7 percent less than the Commission anticipated under the assumption of the constant mail volumes, when a 2 percent of supplemental rate authority is in effect. *See* PR-LR-RM2017-3-1, file Supporting Calculations.xlsx, Worksheet "Vol decl. Effect".

c. Price Elasticities

The Public Representative also evaluated the effect of price elasticities on the rates allowed by the Commission. After implementation of supplemental rate authority, due to the impact of price elasticity only, the Postal Service would collect at least $0.09 billion less in revenues than the Commission's proposal estimated. *See* PR-LR-RM2017-3-1, file Supporting Calculations.xlsx, Worksheet "Elast Effect". This amount

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[22] Docket No. ACR2017, Library Reference USPS-LR-FY17/1, file Public_Fy17CRAReport.xlsx, worksheet "Volume1," Postal Service Econometric Estimates of Demand Elasticity for All Postal products, FY 2017, January 19, 2018, file vf-Jan2018(md).xlsx, Worksheet "Forecast Vols".

[23] Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2011 at 101 (Order No. 1926).

of under-collected revenue due to the elasticity impact is about 3 percent of the additional revenue of $2.7 billion that the Commission would allow to move towards medium-term financial stability.

As Table 2 shows, all Market Dominant Mail classes are still relatively inelastic. In other words, for all mail classes, a rate of revenue growth resulting from a price increase is higher than the rate of mail volume decline. Consequently, supplemental rate authority (2 percent for all classes) and additional rate authority (2 percent for non-compensatory classes, which is Periodicals) should lead to higher revenues for all Market Dominant Mail classes (despite some decline in mail volumes due to the elasticity impact).

Table 2
Impact of the Proposed Price Increases on Market Dominant Mail Annual Volumes and Revenue (by class of mail)

Market Dominant Mail Class	Price Elasticity as of Jan. 2018	Proposed Price Increase (%)	Change in Volume (%)	Change in Revenue (%)
First Class Mail	-0.321	2%	-0.64%	1.35%
Marketing Mail	-0.558	2%	-1.12%	0.86%
Periodicals	-0.195	4%	-0.78%	3.19%
Package Services	-0.802	2%	-1.60%	0.36%

Sources: weighted class-level elasticities are calculated using data from Postal Service Econometric Estimates of Demand Elasticity for All Postal products, FY 2017, January 19, 2018, file vf-Jan2018(md).xlsx, worksheet "Forecast Vols" and "Elasts." Based on the data on price elasticity and proposed (above CPI-U) price increase, the Public Representative calculated change in volume and change in revenue. For more details, *see* PR-LR-RM2017-3-1, file Supporting Calculations.xlsx, Worksheet "Elast Effect".

Although the calculations illustrate that the Commission's proposal gives the Postal Service an opportunity to collect additional revenue over a five-year period and even afterwards,[24] it remains highly unlikely that the Postal Service would recover costs.

d. Conclusion on Volume Declines and Elasticity

The Public Representative concludes that due to both continuing volume decline and elasticity impacts, the proposed supplemental rate authority would bring approximately 10 percent less in additional revenues than the Commission anticipates by its proposal.

Due to multiple reasons, the mail volumes could decline faster (or even much faster) than by a conservative rate of 2 percent per year used in the above calculations and correspondingly, revenue would be lower than estimated above. The primary

[24] Considering that, opposite to the exigent price increase that was effective for a limited time-period, the Commission does not propose to remove a supplemental rate authority after a 5-year period. As a result, the impact of the supplemental rate authority would continue beyond a 5-year time period causing revenues to be potentially higher (compared to a *status quo* situation).

reasons for a faster volume decline include accelerated electronic diversion, successful business activity of competitors, and demographic factors.

In addition, in a different economic environment, (*e.g.,* when volumes decline rapidly and price increases are substantial), Market Dominant Mail classes and products might become more elastic.[25] For example, the Postal Service has estimated that price elasticities for all but one First Class mail products/product categories have increased in absolute value since last year. *See* Table 3. In its turn, the higher the elasticity, the smaller a positive impact of price increases on revenues.

[25] Thus, as the Commission stated in Order No. 3506, "[t]he constant elasticity assumption is unsupported when used for volume levels substantially outside the range of actual experience." *See* Docket No. RM2016-2, Order Concerning United States Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), Updated October 19, 2016 at 8.

Table 3
Price Elasticity of Demand for First Class Mail Products

Market Dominant Mail	**Market Dominant Demand Analysis**	
	Price Elasticity of Demand:	
First-Class Mail:	***January 2017***	***January 2018***
Single-Piece Letters......................................	-0.10	-0.13
Single-Piece Postcards.................................	-0.50	-0.59
Total Single-Piece Letters and Cards.........	**-0.12**	**-0.15**
Presort Letters..	-0.19	-0.41
Presort Cards..	-0.30	-0.36
Total Presort Letters and Cards..................	**-0.19**	**-0.41**
Single-Piece Flats.......................................	-0.12	-0.28
Presort Flats...	-0.37	-0.34
Total Flats...	**-0.22**	**-0.31**
Parcels...	-0.65	N/A
Outbound Single-Piece First-Class Mail Int'l....	**-0.07**	**-0.20**
Average for First-Class....................................	**-0.17**	**-0.32**

* Excludes First Class NSAs and Inbound Letter Post. Price elasticity that have increased are in "red,' while price elasticity that have decreased are in "blue." Price elasticity for each product category and overall class is calculated as a weighted average (by volume). For more details *see* PR-LR-RM2017-3-1, file "Supporting Calculations," Worksheet "Elast FCM".

Source: Postal Service Econometric Estimates of Demand Elasticity for All Postal products, FY 2017, January 19, 2018, folder "Volume Forecasts," Excel file vf-Jan2018(md).xlsx, worksheet "Forecast Vols" and "Elasts;" Market Dominant Demand Analyses, FY 2016, January 23, 2017, folder "Volume Forecasts," file vf-Jan2017(md).xlsx, Worksheet "Forecast Vols" and "Elasts".

Another, but not less important question about whether the Postal Service will cover its attributable costs depends not only on the amount of the collected revenues, but also on the behavior of costs.

Even more troubling is the complete failure of the rules to address reasonably the two most problematic causes of the revenue shortfall in the years since passage of the PAEA: the OPM requirements for huge Postal Service payments beyond management's control and the systemic decline in demand. Drs. Kwoka and Brennan addressed each issue. They provide objective solutions for these problems that continue to require attention.

Arguably, the health benefit fund and pension payments were included within the FY 2017 loss recovered over 5 years by the proposed rules, but Order No. 4258 does not attempt to suggest that the 2 percent adjustment is designed to recover all of the exogenous health benefit and pension fund amounts.

In conclusion, the Commission's 2 percent supplemental allowance solution is backward looking. Losses will not necessarily continue at the FY 2017 level. They are likely to increase. Even if rates eventually recover the equivalent of an immediate single 5.7 percent rate increase, by the fifth year, without the opportunity for adjustments due to exogenous cost changes from either OPM recalculations or volume losses, the Postal Service revenue will continue to be far below costs and the Postal Service will not reach medium-term financial stability.

The Commission is legally required to "examine the relevant data," including the factors discussed above. If the Commission disregards them, it invites a court to consider "whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park,* 401 U.S. at 414. The Commission cannot avoid these considerations and have its decision survive arbitrary and capricious review.

3. Rate Allowances for Non-Compensatory Classes and Products Will Do Little to Relieve Financial Instability, May Be Beyond the Commission's Authority, Are Not Adequately Supported and Arbitrary

The NOPR proposes to require a 2 percent rate adjustment for classes of mail where the attributable cost for that class exceeds the revenue from that class (*i.e*., Periodicals). Proposed 39 C.F.R. § 3010.202, NOPR, Attachment A at 25. It also proposes that for products where the attributable cost exceeds the revenue for that product (*i.e*., currently Marketing Mail Flats and certain other products that have low revenue), the Postal Service must increase the rate for those products by 2 percent without increasing the rate allowance for the class. Proposed 39 C.F.R. § 3010.201, *Id*.[26]

The NOPR recognizes that the non-compensatory Periodicals class has had a large $5 billion negative contribution since FY 2007. NOPR at 81. Non-compensatory classes threaten the integrity of the Postal Service. *Id*. at 82, citing Order No. 4257 at 274. The NOPR anticipates the proposed 2 percent increase will put the non-compensatory class on the "path to having fully compensatory classes." *Id.*

However, the proposed rate allowance will not be sufficient for the Periodicals class to move along the path towards break even. Non-compensatory Periodicals class revenue in FY 2017 was $1.375 billion, a small portion of Postal Service Market Dominant revenue. The 2 percent allowance amounts to $27.5 million of FY 2017 Periodicals revenue, a tiny fraction of the revenue shortfall for the class.

As a practical matter, 2 percent would do very little to reduce the large negative contribution of Postal Service Periodicals revenue. For instance, in FY 2017, Periodicals revenue fell short of attributable costs by $608 million. FY 2017 ACR, USPS-LR-FY17/1, Excel file PublicFY17CRAReport.xlsx, worksheet "Cost1". The 2 percent will do virtually nothing to place Periodicals on the path to full cost recovery. Even when the other allowances are considered, full and fair cost recovery would not be attained in the foreseeable future while the negative contribution will linger around $500 million for at least 2 or 3 years and above $400 million for several more years. "Indeed, it is contrary both to economic efficiency and to good business practice for goods or services to be priced less than their attributable costs." Kwoka/Wilson at 15. This proposal.is not a reasonable path toward medium-term cost recovery.

[26] Because the allowances for products within a class may not increase the overall revenue for the class so those allowances will not realistically assist the Postal Service in gaining medium or long-term financial stability. *See id*. at 81-82.

An additional concern is that the Commission's attempt to direct the Postal Service to file for specific rates for specific products or classes may be construed as inconsistent with Objective 4 to allow Postal Service pricing flexibility and usurps the Postal Service's managerial authority to propose/establish rates.

Moreover, the Commission does not explain the basis for its selection of 2 percent annual increase for the non-compensatory class. The NOPR acknowledges the rate increases will not enable rates for Periodicals to recover costs, but there is no discussion of the reasons for selection of the 2 percent allowance. In addition, the NOPR does not explain why some other percentage rate increase would be less desirable or explain the extent that rate shock may play a part in the decision for such a percentage increase. While the order claims 2 percent represents a balancing of the objectives of increasing pricing efficiency and reasonable rates in Objectives 1 and 8, it will do little to reduce the overwhelming deficit against attributable costs. NOPR at 86-87.

Dr. Kwoka and Dr. Wilson discuss their alternative approach consistent with principles of price caps to adjust the rates to their respective per-unit variable cost to eliminate economic inefficiency and the financial penalty associated with below-coat pricing. Kwok/Wilson Decl. at 5-6, 15-17.

4. The 1 percent Rate Allowance for Performance-Based Incentives is Backward Looking, Lacks Underlying Principles or Reasonable Support and Is Arbitrary and Will Not Accomplish its Intended Purpose

Like the decisional deficiency regarding the supplemental rate authority, Order No. 4258 devised a performance-based mechanism that is backward looking. Rather than devising forward-looking adjustments based upon the future financial requirements of the Postal Service, the NOPR looks to recapture the past and observes the change in capital cash outlays between FY 2006 and FY 2016 of $1.202 billion. It surmises that annual rate increases of 1 percent would raise rates enough to allow the Postal Service to increase its cash investment outlays to the FY 2006 level in two years. NOPR at 54, Table III-1 at 52. Similarly, the NOPR states that in approximately 5 years, a 1 percent additional rate increase would produce enough additional revenue to replace the $7.8 billion reduction in net capital assets that has occurred in the PAEA era from FY 2006 to FY 2016. *Id.* The NOPR tempers these assumptions without any further analysis with a note that, because volumes are declining, these estimates are optimistic and likely, "the amount of additional revenue generated by this proposed performance-based authority will be less than these calculations suggest." *Id*. at 54.

Unfortunately, these calculations are not only overly optimistic but they are misdirected. The 1 percent solution looks to the symptoms of past revenue shortfalls and belatedly seeks to make them up. The proposed performance-based rate authority is not intended to remedy the source of the shortfall, *i.e*., the exogenous costs of the health benefit and pension funds requirements. Rather, it aims to return the Postal Service to investment levels of the past and to the same level of net asset holdings as in the distant past of FY 2006.

An increase in net investment is needed, but there is no demonstration that net asset holdings should to be returned to FY 2006 levels or that 5 years or any other period of time is appropriate to reach that level. Volume has fallen by almost one-third since FY 2006. This suggests that some reduction in assets is appropriate, in any event. There is no discussion on this question. The operational needs of the Postal Service determine the appropriate level of net assets. As volumes decline, capital requirements shift so they will not necessarily remain at the level of 12 years ago (or for 14 years, the earliest date these allowances will first become effective or, for that matter, 19 years--the end date of the five-year revenue enhancement). In addition, the effects of depreciation can alter the value of needed net assets. The need to maintain net assets at any particular past level has not been justified, nor has a 5-year span to return net assets to the FY 2006 level been justified.

It appears the NOPR intends to remedy the lack of long-term financial stability. That remedy is clearly inadequate. The addition of 1 percent performance-based rate authority will, if collected, be necessarily required, instead, to meet the obligations for exogenous costs and, therefore, as a practical matter, will not be available for additional capital outlays or to increase net asset holdings. Accordingly, the Commission's decision to a lot 1 percent in performance-based rate authority is arbitrary and capricious.

a. The Commission Relies On the Historical TFP Operational Efficiency Increases as Rate Incentives Although it Determined They are Insufficient to Maximize Efficiency and the Commission Does Not Offer Sufficiently Reasoned Support for the TFP Rate Allowance of 0.75 percent

The NOPR points to the finding in Order No. 4257 that TFP is the best available measure of efficiency. NOPR at 57, 63; Order No. 4257 at 225. The Commission further determined in Order No. 4257 that:

> [E]fficiency increases were not maximized during the [PAEA era]. In the maximization analysis, the Commission determines that: (1) gains were not achieved in cost reductions and operational efficiency sufficient to contribute to the financial stability of the Postal Service; and (2) cost reductions and operational efficiency increases were not achieved at a greater rate when compared to the relevant time period of the 10 years immediately prior to the implementation of the PAEA.

Order No. 4257 at 248.

The Commission concluded that the PAEA does not maximize incentives to increase operational efficiency in accordance with Objective 1, and that operational efficiency was not maximized under the PAEA. NOPR at 57, Order No. 4257 at 222. The NOPR therefore attempts to modify the rate system "to incentivize the Postal Service to address these deficiencies." *Id*. at 58, Order No. 4257 at 248. Order No. 4258 proposes a 0.75 percent rate allowance incentive for maintaining efficiency.

However, the NOPR does not apply any underlying principle justifying the selection of 0.75 percent for increased rate authority.[27]

The NOPR would grant the 0.75 percent rate allowance for simply maintaining the efficiency gains averaged over the previous 5 years, not for increasing the annual average of the most recent 5 years of efficiency gains. The proposed rate allowance does not provide any incentive to increase the operational efficiency to a level greater than the gains of the last few years. After reviewing the pace of operational efficiency gains in recent years, the Commission determined:

> Accordingly, over the course of the PAEA the Commission has found that efficiency generally increased, but in recent years has begun to slow, with FY 2016 representing the first decline in TFP since implementation of the PAEA ratemaking system.

Order No. 4257 at 221.

Thus, the proposed 0.75 percent rate allowance for maintaining operational efficiency will not require efficiency gains greater than the recent 5 years of operational efficiency gains-- which the Commission has determined are neither sufficient to maximize efficiency under Objective 1 or to address financial stability under Objective 5 of the PAEA.[28] The Supplemental Declaration of Dr. Bzhilyanskaya filed with these Comments expresses the same conclusion that "[c]onsidering this Commission finding, as well as a recent slowdown in a TFP growth, it is reasonable to conclude that the

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[27] The hope of returning annual investments and net asset value to the FY 2006 level with a 1percent.allowance, of which 0.75 is a part, has been shown above to be without sound foundation and unrealistic.

[28] "The existing market dominant ratemaking system did not maximize incentives to increase operational efficiency in accordance with Objective 1." NOPR at 57, *see also* "despite the decline in costs and improvements in operational efficiency, the Commission finds that the incentives to reduce costs and increase operational efficiency have not been maximized as intended by the PAEA because the reductions and improvements were insufficient to address the Postal Service's financial instability." Order No. 4257 at 222.

operational efficiency-based standard should be higher than the average TFP growth in the most recent 5 years." Bzhilyanskaya Supp. Decl. at 7.

Dr. Bzhilyanskaya also objects to the selection of a 5-year average of efficiency gains in order to qualify for the 0.75 percent rate incentive. She states:

> Innovations do not necessarily lead to immediate productivity growth, and the economic impact of technological improvements might not be visible for a number of years after making the investments. [Initial] Bzhilyanskaya Decl. at 8. The Christensen Associates also warned that TFP "has substantial year-to-year variations due to business cycles, the pattern of investment in new technologies, and strategic changes in business plans." Christensen TFP Report at 1. Consequently, it is very possible that any investments for technological improvements would result in a lower 5-year-average TFP growth than it could be without these investments. I would suggest that in order to use an average TFP growth for efficiency-driven incentives, such growth should be measured during a longer period, such as 7-8 years. Bzhilyanskaya Decl. at 8.

Moreover, the NOPR does not include any analysis to demonstrate that 0.75 percent additional rate authority will be sufficient to encourage the Postal Service to maintain the average 0.6 percent productivity growth over the most recent 5 years as determined by the most recent Annual Compliance Determination. Proposed 39 C.F.R. § 3010.181, NOPR at 23-4.[29] There is no record analysis to determine the appropriate level of adjustment for efficiency gains. The order does not explain why or whether the proposed amount is adequate to encourage the Postal Service to strive to maintain its recent unsatisfactory level of efficiency gains. It simply assumes the past rate of gains can continue although the recent level of gains may have been the result of exploiting "low-hanging fruit."

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[29] While the proposed rule would require improved efficiency rate of 0.6 percent, the body of the NOPR states that TFP growth must meet or exceed 0.606 percent. *Id*. at 62, 120.

Another shortcoming of the provision is that the total 0.75 percent rate allowance would yield approximately $360 million to be apportioned among market dominant classes. At best, this amount can assist only in a very small way to move the Postal Service away from financial instability. It only offers increased rate allowances to the Postal Service if it continues to improve efficiency at the rate at which it has managed to accomplish in the last few years, but which the Commission has found does not meet Objectives 1 and 5.

Efficiency gains to counter volume declines. Order No. 4258 also notes incidentally that to qualify for the TFP rate authority, not only must TFP improvements continue, but also that greater efficiency gains are necessary to counter systemic volume declines over the next five years. Order No. 4258 states:

> Given these recent volume trends and the effects of price elasticity,[30] the assumption of constant mail volumes results in revenue estimates the Commission reasonably anticipates will be higher than the revenues that the proposed rate adjustment authority would actually generate. Accordingly, the Commission intends for the Postal Service to achieve cost reductions and *operational efficiency gains* sufficient to close the gap between total revenue and total costs. (Emphasis supplied.)

Id. at 41-42.

This rather offhand suggestion erroneously ties the reward for efficiency gains under management's control with systemic drops in demand outside management's control. There is no analysis of the potential impact that volume declines will have upon efficiency gains in the future. Order No. 4258 has no analysis tying systemic demand reductions to efficiency. Thus, Order No. 4258 lacks a provision that reasonably incentivizes the Postal Service to improve efficiency to offset the impact of declining demand. The Public Representative presents another more direct and precise method

[30] *See* Order No. 4257 at 127-130.

for adjusting for volume decline in the Statement of Dr. Brennan filed with these Comments. Dr. Brennan's adjustment for volume declines represents a more appropriate and direct price cap adjustment to recognize in the price cap declining mail volumes.

b. There is No Reasoned Support for the Service Performance Rate Allowance of 0.25 percent Because There Is No Showing That It Provides an Adequate or Necessary Incentive to Maintain Service

The NOPR proposes a service quality based rate authority of 0.25 percent. *Id*. at 71. The NOPR does not include any supporting analysis to demonstrate that the 0.25 percent annual rate authority offers sufficient incentive to maintain Service Standards (and business rules). Just as significantly, Dr. Kwoka and Dr. Wilson believe that "Under present circumstances, offering stronger incentives for higher quality, or even maintaining quality, will not address the underlying issues. We therefore reiterate our belief that a policy of stronger incentives attacks the symptoms, rather than the cause, of the problem." Kwoka/Wilson Decl. at 15. Rather, they recommend a policy of revenue restoration. *Id*.

The additional rate allowance would amount to, at most, an increase in market dominant product revenue of $120 million based on FY 2017 Market Dominant revenue of over $147 billion, and only a fraction of that $120 million for each class of service.[31] It cannot be reasonably claimed without some determination upon record analysis that this relatively small amount of potential revenue, if weighed against potential cost

[31] The Postal Service reported total FY 2017 revenue from market dominant products in its most recent Annual Compliance Report (ACR). Docket No. ACR2017, United States Postal Service FY 2017 Annual Compliance Report, December 29, 2017. Total revenue was approximately $47.4 billion consisting of $26.7 billion from First-Class Mail products; $16.7 billion from Marketing Mail products; $1.4 billion from Periodicals; $0.8 billion from Package Services; and $1.8 billion from Special Services. *See* ACR at 8, 13, 38, 40, and 43.

savings from a system-wide reduction in service, would incentivize the Postal Service to maintain service standards (and/or business rules) that it wants to reduce. The likely savings from a change in service standards (and/or business rules) could easily surpass the potential recovery of 0.25 percent rate allowance that would not begin to be recovered until these incentive rates go into effect, whereas savings from reduced service standards could be generated immediately. Moreover, this potentially small increase in revenue of 0.25 percent would be realized only after being in effect for a full year and, in any event, will not move the Postal Service very much along the path toward financial stability.

Thus, there is no record analysis to determine that the appropriate level of adjustment for maintaining service standards is 0.25 percent or why and whether 0.25 percent would be adequate to encourage the Postal Service to maintain service standards. Nor is there any analysis of the impact upon the financial stability of the Postal Service. This incentive will do nothing to relieve financial pressure on the Postal Service.

If the Commission can justify these rate allowances for service performance overall, rather than separating efficiency and service standards, it might consider tying the two incentives together by requiring *both measures to be met* before qualifying for the 1 percent rate allowance of approximately $480 million.

D. Conclusion of Deficiencies of Order No. 4258 Designed for Achieving Financial Stability

Although the Commission concluded that the Postal Service is not financially stable, and therefore not achieving the PAEA's objective to achieve financial stability, the proposed rules fail to adequately deal with the causes of the problem. The proposed rules are based upon: (1) an erroneous conclusion regarding short-term financial stability; (2) unprincipled and unsupported solutions to achieve the medium and longer-term financial stability objective; and (3) a failure adequately to support proposed rate adjustments for both TFP and Service Standards.

Taken together, the proposed rules are arbitrary and capricious. The Commission's order grants additional rate authority under the price cap without anchoring that authority to any cognizable analytical framework, leaving it vulnerable to appeal as an arbitrary and capricious decision. Instead, the Commission appears to base its determination on the Postal Service's FY 2017 losses, in lieu of a multiyear average or other, more comprehensive metric. This choice would invite a court to "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park,* 401 U.S. at 414. Additionally, the Commission also effectively disregards other significant factors, such as declining demand. For this reason, it is not clear that the Commission "examine[d] the relevant data." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. The Commission does not consider fully the alternative proposed by the Public Representative of applying the principle of including within the price cap measures to reflect exogenous costs outside the control of management to relieve the Postal Service's financial instability. Throughout its order, the Commission fails to "articulate a satisfactory explanation" for the quantities of additional rate authority it proposes to provide the Postal Service and the relationship between that additional authority and the existing system of price cap regulation.

IV. TIMING OF EFFECTIVE DATES OF PROPOSED RULES

A. Short–Term Financial Instability Requires Rate Relief Earlier than Proposed

Order No. 4258 does not discuss the potential impact of delay between compilation and consideration of the record in this proceeding and the effective date of the new supplemental rates. The rates authorized by these rules may not become effective until January 2020, about two years from the date of these Comments; in other words, 2.5 years after the benchmark FY 2017 earnings report issued in October 2017, and almost 14 years after the passage of the PAEA. The Postal Service's financial instability dictates the need for authorization for immediate revenue relief. The restriction in the proposed rule that these rates must be included in the first rate filing of the year must be relaxed if the Postal Service is able to file for relief late in 2018 after its annual filing for rates effective in January 2019.

B. The Five-Year Period Before the Next System Review Is Too Long

Order No. 4258 concludes that commencing review after 5 years when the supplemental rate authority expires is reasonable to avoid too frequent reviews. NOPR at 37. However, the order does not mention, or seem to consider, the problem created by delaying review until after the price cap adjustments terminate and thereby creating a rules gap pending completion of reset review. Where fast moving changes in underlying conditions, over time, expand the discrepancy between costs and revenue, the commencement of reset review should not delay. Reset review could easily extend beyond one year and the opportunity for necessary annual rate adjustments for exogenous costs and volume losses or other costs to meet obligations to the U.S. Treasury could be lost. If the Commission decides to phase–in rate authority over four years, or even five years as proposed in Order No. 4258, review should start no later than the year prior to termination of the rules granting supplemental and additional rate authority to ensure timely opportunity to adjust the price cap.

Dr. Kwoka and Dr. Wilson believe that the length of time between regulatory review in an important feature of price cap plans to ensure the parameter are sound. Kwoka/Wilson at 18. Dr. Kwoka and Dr. Wilson recommend a 3-year period between reviews to minimize the concern that revenue will depart too much from costs and exacerbate financial difficulties. Kwoka/Wilson Decl. at 17-18. Commission review should begin no later than 3 years after the effective date of the rules, or at least review should start no later than the year prior to termination of the rules granting supplemental and additional rate authority. Dr. Kwoka previously expressed his view that “[i]t is critical under a price cap regime to be able to revisit a plan’s performance quickly enough to prevent either persistent windfalls to the firm that harm consumers or persistent revenue shortfalls that damage the producer. *See* Kwoka Decl. at 11-12.

V. THE PUBLIC REPRESENTATIVE’S RECOMMENDATIONS

A. Recommendation 1: Retain Price Cap and Make Principled Adjustments Consistent with Price Cap Theory

In its NOPR, the Commission proposes to continue use of the price cap regime for market dominant products and services and to give the Postal Service “additional pricing authority…to achieve the objectives of the PAEA.” Order No. 4258 at 34. The Public Representative supports the retention of the price cap with necessary modifications. Continued implementation of the price cap regime still has the potential for providing stability, predictability, transparency, and incentives for efficient Postal Service operations. Moreover, continued implementation of a properly revised price cap regime provides a platform for further improvements in future system reviews that build upon successful elements of the system.

The Public Representative supports the Commissions goal of making additional revenue available to the Postal Service, but cannot support the specific measures proposed in the NOPR. The Commission’s proposed adjustments to the system consist of a collection of ad hoc measures that lack adequate support. In Section III, above, the Public Representative identifies and discusses significant problems with the Commission’s proposed remedies. At a minimum, the proposed adjustments are subject to claims that they are arbitrary, capricious, and inadequate.

By contrast, each of the recommendations made in the Public Representative’s earlier comments were based upon recognized price cap principles. Those recommendations addressed three fundamental shortcomings of the current price cap system that emerged over the past 10 years. Those recommendations were supported by the sworn declarations of four professional economics and regulatory specialists, Dr. John Kwoka, Dr. Robert Wilson, Dr. Timothy J. Brennan, and Dr. Lyudmila Bzhilyanskaya. *See* notes 4, 5, and 6, *supra*.

Because the system did not have an adequate mechanism for permitting recovery of so-called exogenous costs—costs that are beyond management's ability to control—the Public Representative recommended that the price cap be adjusted to incorporate a "Z-factor" that would pass exogenous costs through on a dollar-for-dollar basis. PR 2017 Comments at 35-47. Support for this recommendation was provided by Dr. Kwoka. Kwoka 2017 Decl. at 25-26.

Because the price cap did not make provision for declining demand, the Public Representative recommended that the price cap be adjusted to incorporate a further "Z-factor" adjustment that would that would adjust annually for declining demand. PR 2017 Comments at 47-56. Support for the Public Representative's recommendation was provided by Dr. Brennan. Brennan 2017 Decl. at 13-25.

Because not all rates were compensatory at the time price caps were imposed, the Public Representative recommended that there be a one-time reset of the price cap for the Periodicals Class that would permit the Postal Service to collect rates as near as possible to estimated total costs. *Id.* at 56-57. Support for the Public Representative's recommendation was provided by Dr. Kwoka. *See* Kwoka Decl. at 6-7.

As an alternative to price cap adjustments sponsored by Drs. Kwoka and Brennan, the Public Representative recommended a general reset of the price cap so that revenues after reset would equate as nearly as feasible too total costs. PR 2017 Comments at 58. This recommendation was consistent with Dr. Kwoka's view that, under price cap regulation, mid-course corrections after four or five years are appropriate to restore the correspondence between price and cost. *Id.* (citing Kwoka 2017 Decl. at 6-7, 12). It should be noted that this alternative of total cost reset might appear to equate to Dr. Kwoka's adjustment for exogenous costs in a "Z-factor" plus CPI-U. They are distinctly different. Dr. Kwoka's formula would not set rates at total cost. His rates would consist of starting with current rates, increased only by the change in CPI-U plus exogenous costs as defined. Current Cpi-U-based rates plus exogenous costs would not be as high as total costs when total losses exceed exogenous costs.

Finally, the PAEA's 10-year deferral of a comprehensive assessment of the market dominant system exacerbated the effects of the Postal Service's inability to recover exogenous costs, overcome declining demand, and make historically non-compensatory products profitable. PR 2017 Comments at 60-61.

In a joint sworn declaration accompanying these comments, Dr. Kwoka and Dr. Wilson support the use of established price cap principles to adjust the price cap. *See, e.g.,* Kwoka/Wilson Decl. at 5-6. This recommendation is consistent with and supported by Dr. Kwoka's earlier declaration in which he identifies the economic and policy reasons underlying price cap regulation. *See* Kwoka Decl. at 5-11. Principled adjustments are essential for several reasons. Principled adjustments address design flaws in the original price cap that were causes of the Postal Service's financial difficulties. Kwoka/Wilson Decl. at 12 (failure to recognize exogernous costs), 17 (failure to adjust the price cap for declining demand). Principled adjustments address causes, not symptoms, of price cap deficiencies by reflecting economic factors that cause underlying costs to change. *Id.* at 7, 14, 15. By contrast, *ad hoc* adjustments, like those proposed by the Commission, invite tinkering that leaves underlying problems unaddressed. *See id.* at 5.

For the foregoing reasons, the Public Representative urges the Commission to base adjustments to the price cap mechanism on recognized principles of price cap regulation as recommended below.

B. Recommendation 2: Adjust the Price Cap for Exogenous Factors

The Public Representative previously recommended adjustments to the price cap for two types of exogenous factors—exogenous costs and declining demand. PR 2017 Comments at 35-41; 52-53. Those adjustments were supported by Dr. Kwoka and Dr. Brennan in their initial declarations. Kwoka Decl. at 24-265; Brennan 2017 Decl. at 15-25. In the supplemental declarations, discussed below, Dr. Kwoka and Dr. Wilson, together with Dr. Brennan, continue to support adjustments for exogenous factors.

1. Adjustment to Address Uncontrollable Costs

At the time the Public Representative filed his earlier comments, unfunded Retiree Health Benefit (RHB) costs were a prime example of exogenous costs the Postal Service had tried, without success, to pay according to the statutory schedule prescribed by the PAEA.

It was anticipated by the General Accountability Office (GAO) and others that the OPM's 2017 recalculation of unfunded RHB payments would require the Postal Service to make annual payments of approximately $2.6 billion. PR 2017 Comments at 41-44. It was this amount that the Public Representative suggested be recovered as a Z-factor adjustment to the price cap. *Id.* at 44-47.

Since the filing of the Public Representative's earlier comments, the amounts and nature of the Postal Service's exogenous costs have changed significantly. Some employee benefits costs have decreased, while other benefit costs have increased. First, the expected amount of annual payments for unfunded RHB payments has been reduced from the anticipated $2.6 billion to $0.955 billion.[32] Second, the Postal Service

[32] *See, e.g.,* FY 2017 Form 10-K at 5. Letter from Dennis D. Coleman, Chief Financial Officer, Office of Personal Management to Joseph Corbett, Chief Financial Officer, United States Postal Service, July 30, 2017 (July 30, 2017 OPM Letter). That reduction was due to the fact that the RHB lump sum

has for the first time been billed for RHB normal costs which included $0.527 billion due to actuarial changes. FY 2017 Form 10-K at 17. Third, the Postal Service has for the first time since 2006 been billed $1.741 billion for supplemental Civilian Service Retirement System (CSRS) liability.[33] Finally, the Postal Service has been billed $0.917 billion for Federal Employee Retirement System (FERS) unfunded liability. FY 2017 Form 10-K at 14. These four amounts total $4.145 billion, approximately 8.8 percent of about $47 billion of annual Postal Service market dominant revenues. This $4.145 billion should be the starting point for considering adjustments to the price cap.

a. RHB Unfunded Payments - $0.955 billion

In FY 2017, the Postal Service was to begin making annual payments to amortize the remaining RHB unfunded liability over a period of 40 years through FY 2056. FY 2017 Form 10-K at 39. OPM's recalculation did not include the $33.9 billion of unfunded liability that the Postal Service failed to pay between 2006 and 2016 (Defaulted RHB Payments). Instead, the defaulted amounts were entered on the Postal Service's balance sheet as a current liability.[34]

To amortize the remaining RHB unfunded liability over a period of 40 years (as required by the Postal Accountability and Enhancement Act (PAEA)), OPM calculated annual lump sum payments of $955 million.[35] This is far less than the amount that had

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payment defaults between 2012 through 2016 were not included in the amount of unfunded RHB liabilities used by OPM to calculate future annual RHB unfunded liability payments.

[33] *See, e.g.,* FY 2017 Form 10-K at 39. Letter from Dennis D. Coleman, Chief Financial Officer, Office of Personal Management to Joseph Corbett, Chief Financial Officer, United States Postal Service, June 28, 2017 (June 28, 2017 OPM Letter).

[34] *See* FY 2017 Form 10-K at 55. There is currently no deadline for payment of this amount. However, OPM appears to have the right to require the Postal Service to make "progress payments" to discharge its obligations. *See* FY 2016 Financial Report at 74, n.56.

[35] As of September 30, 2016, the Postal Service also had $19.8 billion of additional unfunded PSRHBF liability. It is this latter amount that was used by OPM to calculate the annual unfunded RHB amount for FY 2017 and future years. July 30, 2017 OPM Letter at 1.

originally assumed would be used to calculate the exogenous price cap adjustment that the Public Representative proposed.

The FY 2017 payment as invoiced to the Postal Service by the Office of Personnel Management (OPM) was $955 million. FY 2017 Form 10-K at 32. The Postal Service recorded the $955 FY 2017 amortization payment obligation as an expense, but did not make the payment. *Id.* at 55. Instead, this amount was also reported on the Postal Service's balance sheet. *Id.* The annual estimated payment for unfunded liability expense is estimated to be approximately $1 billion annually from FY 2018 through FY 2022. *Id.* at 32. The Postal Service states that, if necessary, it will continue defaulting on these payments in FY 2018 and beyond. *Id.* at 40.

b. RHB Normal Cost Payments – includes $0.527 billion actuarial changes

Beginning in FY 2017, the Postal Service was required to pay $3.3 billion of so-called "normal costs" into the RHB fund. "Normal costs" are the costs of future benefits that current employees earn each year they work. Included in the $3.3 billion FY 2017 normal cost payment obligation is $527 million due to actuarial changes. *See* FY 2017 Form 10-K at 17. The Postal Service was billed, but did not pay, the $3.3 billion RHB normal cost. *Id.* at 55. The $3.3 billion was included on the Postal Service's balance sheet as a current liability. *Id.* The Postal Service states that, if necessary, it will continue defaulting on these payments, that include $0.527 billion of normal cost actuarial changes, in FY 2018 and beyond. *Id.* at 40.

c. CSRS Unfunded Liability Payments - $1.741 billion

As of September 30, 2017, unfunded CSRS retirement benefits totaled $26.3 billion. FY 2017 Form 10-K at 11. For the first time since the imposition of the price cap in 2007, OPM billed the Postal Service for CSRS unfunded liability of approximately $1.741 billion for FY 2017. This amount will be due annually until 2043. FY 2017 10-K at 39. FY 2017 Form 10-K at 39. This amount was also determined actuarially. *Id.* at 26. This amount will be billed annually until FY 2043. *Id.* at 39. The Postal Service failed to pay this amount and it was recorded as an expense and as a current liability on the Postal Service's balance sheet. *Id.* at 55 and 27. The Postal Service states that, if necessary, it will continue defaulting on these payments in FY 2018 and beyond. *Id.* at 40.

d. FERS Unfunded Liability Payments - $0.917 billion

As of September 30, 2017, unfunded FERS retirement benefits totaled $15.7 billion. FY 2017 Form 10-K at 11. OPM has also billed the Postal Service for Federal Employees Retirement System (FERS) unfunded liability of approximately $917 million for FY 2017. (This amount is separate from FERS normal costs that were paid in FY 2017). The FERS unfunded liability payment was determined actuarially (like the $527 million portion of the RHB normal costs and CSRS costs that were also determined actuarially) and will be due annually until 2046. FY 2017 10-K at 39. The Postal Service defaulted on this payment and the $917 was entered on the Postal Service's balance sheet as a current liability. FY 2017 Form 10-K at 27. The Postal Service's states that, if necessary, it will continue defaulting on amounts this magnitude in FY 2018 and beyond. *Id.* at 40.

Together, the RHB unfunded liability cost ($0.955 billion), the actuarial portion of the RHB normal cost payment ($0.527 billion), the CSRS actuarially determined unfunded liability payment ($1.741 billion), and the FERS actuarially determined unfunded liability payment ($0.941 billion) total $4.1 billion. Unlike the $2.7 billion FY 2017 loss referred to by the Commission as the basis for supplemental rate authority, this $4.1 billion unfunded liability for RHB, CSRS, and FERS health and pension benefits will be an annual obligation for decades.[36]

In their joint declaration, Dr. Kwoka and Dr. Wilson confirm that the mandatory prefunding of retirees' future health benefits should be integrated into the price cap as an exogenous cost. Kwoka/Wilson Decl. at 12. They also conclude that the annual payments to amortize unfunded CSRS and FERS liabilities should be included as Z-factors in the price cap formula. *Id.* at 13. In doing so, they note that the Postal Service is required to participate in pension and health and benefit programs and has no control or influence over the benefits. *Id.* at 12. The lack of control over these costs is further demonstrated by the fact that the amounts are actuarially determined. FY 2017 10-K at 17, 26, 39.

All of the foregoing unfunded liability costs are exogenous costs that should be recovered by means of an adjustment to the price cap in order to give the Postal Service the opportunity to achieve financial stability. Failure to give the Postal Service an opportunity to recover these costs through its revenues would permit incorrect plan parameters to penalize the Postal Service indefinitely. Kwoka/Wilson Decl. at 13.

Phase-in Price Cap Adjustment. Balanced against the Postal Service's need for additional revenues is the interest of mailers in predictability and stability of prices. For that reason, the Public Representative does not recommend an immediate $4.1 billion adjustment to the price cap. Instead, the adjustment should be phased-in over the period between the date of implementation and the conclusion of the next regularly scheduled review of the market dominant system.

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[36] This amount is, of course, subject to change for several reasons, including the enactment of postal legislation and future Commission proceedings. *See* Docket No. SS2018-1, Request of the United States Postal Service for Review of the Office of Personnel Management's Determination Regarding Civil Service Retirement System Liability, November 13, 2017; Docket No. SS2018-2, Request of the United States Postal Service for the Commission to Conduct a Review of the Office of Personnel Management's Determination Regarding Retiree Health Benefits Liability, January 1, 2018. The potential effects of these latter potential developments is discussed *infra.*

In Section V.D., below, the Public Representative recommends that the Commission should plan to conduct the next market dominant system review in three years. Assuming the next system review began after 3 years and concluded 1 year later, the phase-in period would last for 4 years. Following the Commission's methodology, the Public Representative estimates that the adjustment to the price cap needed to authorize an additional $4.145 billion of revenue over 4 years, starting with an annual increase of 3.44 percent, would be as shown in Table 4.[37]

[37] The Public Representative applies the same methodology described in footnote 23, above using the assumptions about constant volumes and no elasticity effect. The Public Representative uses a 3 percent discount rate.

Table 4
Additional Revenue for Market Dominant Mail over a 4-year -Period with $4.1 Billion of Exogenous Cost Rate Authority
($ billions, Present Value)

	Year 1	Year 2	Year 3	Year 4	Over 4 years	Annualized
Additional Revenue	1.63	3.29	4.98	6.69	16.59	4.15

Source: Library Reference PR-LR-RM2017-3/1, Worksheet file Supporting Calculations.xlsx, Worksheet “Suppl Auth Calc”.

The magnitude of phased-in additional rate authority over 4 years to fund $4.1 billion of exogenous costs would be approximately 3.44 percent in Year 1, 6.94 percent in Year 2, 10.51 percent in Year 3, and 14.11 percent in Year 4. The annualized increase over four years would be 3.58 percent.

If a 3-year phase-in period were employed, the Public Representative estimates that the adjustment to the price cap needed to authorize an additional $4.145 billion of revenue would be as shown in Table 5. *Id.*

Table 5
Additional Revenue for Market Dominant Mail over a 3-year Period with $4.1 Billion of Exogenous Cost Rate Authority
($ billions, Present Value)

	Year 1	Year 2	Year 3	Over 3 years	Annualized
Additional Revenue	2.04	4.13	6.27	12.43	4.15

Source: Library Reference PR-LR-RM2017-3/1, Worksheet “Suppl Auth Calc”.

The magnitude of phased-in additional rate authority over 3 years to fund $4.1 billion of exogenous costs is approximately 4.30 percent in Year 1, 8.71 percent in Year 2, and 13.23 percent in Year 3. The annualized increase over three years would be 4.475 percent.

By comparison, the recent exigent rate increase amounted to an annual across the board increase of about $2.1 billion, a 4.3 percent rate increase. After the rates were implemented in January 2014, through 2015 and into April 2016, there was a limited impact on volume. PR 2017 Comments at 45-46. The experience with the exigent rate increase strongly suggests that an exogenous cost adjustment to the price cap of at least the magnitude of the exigent surcharge ($2.1 billion) could provide the Postal Service with additional revenues without a significant adverse impact on mail volume.

Using a 4-year phase-in period, additional annual revenues would not reach $2.1 billion until sometime during Year 2. Using a 3-year phase-in period, additional annual revenues would reach $2.1 billion at some point during Year 1. Of the two methodologies, the 3-year phase-in would give the Postal Service more additional revenue sooner.

In the years that follow, as the exogenous price cap adjustment increases, the potential impact on mail volume can be expected to increase. Due to elasticity effects and continued volume declines, the Public Representative would expect the Postal Service to collect less in additional revenue than the amounts presented in Table 4 and Table 5. Since the additional exogenous cost rate authority will be in effect for a shorter time period than the Commission's proposals, the effect of volume decline trends on revenue will be smaller. However, higher annual price increases will lead to higher volume losses due to the elasticity effect. Considering these two impacts, the Public Representative estimates that the additional revenue the Postal Service will be able to collect will be approximately 10 percent less than $4.145 Billion. This estimate is consistent with the estimate provided in Section III.VC.2., above, for the same two impacts. As discussed there, implementation of the supplemental rate authority proposed by the Commission would likely collect at least 10 percent less in additional revenue than $2.7 billion. *Id.*

Potential Impact of Possible Postal Legislation. A further consideration with implications for the timing and amount of exogenous cost adjustments to the price cap is the possibility that postal legislation will be enacted. On March 16, 2017, H.R. 756, the Postal Service Reform Act of 2017, was voted out of committee by the House Oversight and Government Affairs Committee with bipartisan support.[38] Changes made by the bill would have important implications for the Postal Service's financial situation and the market dominant system of regulation. These changes would:

- Greatly reduce or eliminate the Postal Service's unfunded liability for retiree health benefits (Section 102);
- Require OPM to use more favorable employee demographics in calculating Postal Service pension liabilities under the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS) (Section 103); and
- Restore on a one-time basis approximately one-half of the exigent surcharge that had previously compensated the Postal Service for the effects of the Great Recession (Section 207).

These changes address exogenous factors over which the Postal Service has no control. Changes to retiree health benefits and pension benefits will affect exogenous costs currently being borne by the Postal Service. The restoration of one-half of the exigent surcharge provides partial relief for the decline in demand which is also an exogenous factor.

However, H.R. 756 or any bills that may later be patterned after it will not provide the Postal Service with relief unless and until one of those bills is passed by both Houses of Congress and signed into law. In the meantime, it is the Commission's

[38] H.R. 756, the Postal Service Reform Act of 2017 (as passed by H. Oversight and Government Reform Comm., March 16, 2017 (H.R. 756).

responsibility to address the shortcomings it has already identified in the existing price cap system.

Even if the retiree health benefit and pension reforms in H.R. 756 were adopted, there would still be a need for current exogenous cost adjustments to the price cap.[39] That need is supported by information presented in testimony by the Postmaster General to the House Oversight and Government Reform Committee on February 7, 2017.[40] On page 17 of her testimony, the PMG presented a table that showed the value of different parts of H.R. 756 from 2018 through 2022. *Id.* at 17. In relevant part, the table showed as follows:

[39] Enactment of H.R. 756 (or another bill with the same provisions) also would not resolve all of the issues now before the Commission. For example, H.R. 756 does not address the problems presented by non-compensatory products and classes. Although H.R. 756's restoration of one-half of the exigent surcharge would effectively provide pricing relief for approximately half of the mail volume losses due to the Great Recession. Left unresolved would be questions regarding whether and, if so, how price cap adjustments should be made to offset future volume declines.

[40] Statement of Postmaster General and Chief Executive Officer, Megan J. Brennan, House Oversight and Government Reform Committee Hearing, February 7, 2017 (PMG Testimony).

Table 6
USPS Potential Savings
With Legislated Medicare Integration Parts A, B, and D
($ in billions)

	Provision	2018	2019	2020	2021	2022	Total 2018-2022
A	Medicare integration for postal retiree health plans (including savings from lower RHB liability)	4.1	3.3	3.2	3.2	3.0	$16.8
B	Exigent Surcharge at 2.15%	0.8	0.8	0.8	0.9	0.9	$4.2
C	Retirement liability calculation using postal-specific assumptions	0.7	0.8	0.8	0.9	0.9	$4.2

Note: By its title, this table purports to show “savings.” Two of the lines (Line A and Line C) show projected reductions in Postal Service costs and are, in the sense commonly understood, projected “savings.” Line B, however, represents increased revenues to the Postal Service, not savings in the same sense as the savings shown on Line A and Line C. From the Postal Service’s perspective, of course, both reduced costs and increased revenues contribute to a better bottom line.

The “savings” shown in this table (whether in the form of decreased costs or increased revenues) tell only part of the story. The question that remains to be considered is how much of the exigent costs that the Public Representative proposes to use to adjust the price cap would remain after the projected savings from H.R. 756 have been realized.[41] Information regarding the projected costs over the same period from 2018 through 2022 can be found in the Postal Service’s FY 2017 Form 10-K:

[41] This assumes that all of the savings projected from H.R. 756 are used to reduce the Public Representative’s proposed exogenous cost adjustments.

Table 7
USPS Potential Health Benefit and Pension Costs
($ in billions)

	Provision	2018	2019	2020	2021	2022	Total 2018-2022
A	RHB Normal costs Amortization of unfunded liability (Note 1)	3.5 1.0 4.5	3.7 1.0 4.7	3.9 1.0 4.9	4.0 1.0 5.0	4.2 1.0 5.2	$24.3
B	CSRS Unfunded liability FERS Unfunded liability (Note 2)	1.741 .917 2.658	1.741 .917 2.658	1.741 .917 2.658	1.741 .917 2.658	1.741 .917 2.658	$13.3

Note 1: Source – USPS FY 2017 Form 10-K at 32.
Note 2: Source – USPS FY 2017 Form 10-K at 39.

When all of the projected health cost and pension cost savings shown in the table from the PMG's Congressional testimony are subtracted from the exogenous costs projected for retiree health benefit and pension costs in the Postal Service's FY 2017 Form 10-K, the remaining exogenous costs are:

Table 8
Net USPS Exogenous Health Benefit and Pension Costs
($ in billions)

	Provision	2018	2019	2020	2021	2022	Total 2018-2022
A	RHB Normal costs Amortization of unfunded liability	0.4	2.4	1.7	1.8	2.2	$8.5
B	CSRS Unfunded liability FERS Unfunded liability	1.958	1.858	1.858	1.758	1.758	$9.2
C	Total	2.358	4.258	3.558	3.558	3.958	$17.7

The average annual net exogenous cost adjustment under H.R. 756 would be approximately $3.54 billion ($17.7 / 5). This is less than the $4.145 billion exogenous cost adjustment proposed by the Public Representative. However, it must be remembered that in the preceding calculation, all of the proposed savings from H.R. 756 have been used to reduce the exogenous cost adjustment. At least some of the pension cost savings for FERS pension liabilities would be used to reduce FERS normal costs and FERS normal costs were not included in the above calculation. Accordingly, the annual net exogenous cost adjustment of $3.54 billion is likely understated.

Enactment of H.R. 756 would solve some of the major financial problems faced by the Postal Service. However, until it is enacted, the Public Representative's position will be that the changes to the current market dominant system being advocated herein should be adopted promptly. If, and when, H.R. 756 is enacted, the Commission should consider further changes to the system as legally authorized and appropriate.

2. Adjustment to Address Declining Demand

At the time the PAEA was enacted, the hope was that anticipated demand declines could be effectively accommodated by reductions in cost, increases in productivity, and innovation. *Id.* at 20 (citing S. Rep. No. 108-318 at 3). What was not anticipated was the magnitude, speed, and persistence of the declines in demand for postal services. PR 2017 Comments at 20. The Postal Service's ability to overcome these declines by means of cost cutting, improved productivity, and innovation proved to be far less than what was needed.

The Public Representative's prior comments recommended annual adjustments to the price cap for declining demand. PR 2017 Comments at 47-56. Dr. Brennan, Dr. Kwoka, and Dr. Wilson all view declining demand as an exogenous factor. Brennan Decl. at 10-12; Kwoka Decl. at 25-26; and Kwoka/Wilson Decl. at 6,17. Dr. Brennan presented a specific proposal for adjusting the price cap for declining demand. Brennan Decl. at 13-25. His proposed mechanism was designed as an annual percentage adjustment to price, just as the CPI-U adjustment is an adjustment to the price cap. *Id.* at 16. The mechanism is based upon five principles:

- The goal of the adjustment is “net revenue neutrality”
- The adjustment mechanism must be simple
- The adjustment mechanism is based upon events outside of Postal Service control
- The adjustment mechanism only responds to adverse financial effects of declining demand
- The adjustment mechanism also applies to increasing demand

Brennan 2017 Decl. at 13-15.

Dr. Brennan’s proposed adjustment mechanism employed only three terms: (1) the percentage that demand had declined; (2) the elasticity of average cost; and (3) the price elasticity of demand for the service. *Id.* at 15-18. After describing these terms and how they were to be used, he presented a simplified numerical example for illustrative purposes. *Id.* at 18-20. His example calculated a 14 percent adjustment to the price cap over the ten year period from 2007 through 2016. *Id.* at 19-20. The average annual increase over this period was approximately 1.3 percent. *Id.* at 20. Dr. Brennan concluded with a discussion of implementation issues that might arise with each of the three components of the proposed mechanism. *Id.* at 20-25. He readily admitted that implementation issues would not be free from complexities and controversy. *Id.* at 21. The Commission did not discuss Dr. Brennan’s proposed adjustment mechanism for declining demand. However, declining demand remains a significant problem that cannot and should not be ignored.

To facilitate consideration of Dr. Brennan’s proposed adjustment mechanism, the Public Representative requested Dr. Brennan to clarify and expand upon his prior declaration. In his supplemental declaration, Dr. Brennan provides clarifications, expanded discussion, and sample calculations for four classes of market dominant mail: First-Class Mail, Marketing Mail (formerly Standard Mail), Periodicals, and Package

Services. Brennan Supp. Decl. at 3-7. Dr. Brennan concludes with some observations on implementation. *Id.* at 9-12.

In the event the Commission chooses not to establish an adjustment of the price cap for declining demand, it should nevertheless investigate methods for making such adjustments. The Commission can, for example, establish a public inquiry proceeding to explore both conceptual and implementation issues. The goal should be to explore the issue in advance of the next review of the market dominant system.

C. Recommendation 3: Adjustment to Address Non-Compensatory Rates

The Public Representative previously recommended adjustment of the price cap applicable to the Periodicals Class to permit the recovery of its total costs. PR 2017 Comments at 3, 56-57. The Public Representative's recommendation was based on Dr. Kwoka's assertion that such an adjustment would be consistent with the principle that price caps are to be initialized or reset to cover total costs. *Id.* at 56 (citing Kwoka Decl. at 6-7). As Dr. Kwoka stated "unless some action is taken to recover the attributable costs of Periodicals…the Postal Service can continue to provide such services only by overcharging for other services and/or by reducing service quality and investments in its overall operations." Kwoka Decl. at 27 (footnote omitted).

The problem of non-compensatory rates for Standard Mail Flats (since renamed Marketing Mail Flats) was different. Revenues for the Standard Mail Class (in which the Standard Mail (Marketing Mail) Flats product is included) exceeded attributable costs. As Dr. Kwoka noted, the solution to non-compensatory rates for the flats product could be addressed by raising rates for flats provided offsetting reductions were made in the prices of other Standard Mail products. Kwoka Decl. at 27.

In Order No. 4258, the Commission discusses the problem presented by non-compensatory prices both at the product level within classes that are compensatory and at the class level when the entire class pays non-compensatory rates. Order No. 4258 at 73-87. In the case of non-compensatory products within compensatory classes (such as Marketing Mail Flats), the Commission would require the Postal Service to increase non-compensatory product prices a minimum of 2 percent per year above the percentage increase for the class whenever it seeks to adjust rates for that class. *Id.* at 80. The Commission acknowledges that requiring the Postal Service to increase prices limits the Postal Service's pricing flexibility. *Id.* at 77. This is a departure from the usual practice of allowing the Postal Service to decide how to price its products. .

The Commission also addresses the problems presented by the non-compensatory Periodicals Class. It presents information regarding the significant losses sustained by the class since enactment of the PAEA. *Id.* at 81. It also points to the unique circumstances presented by the fact that both products in the Periodicals Class—In-County Periodicals and Outside County Periodicals—are non-compensatory. *Id.* Under that system, prices for one product can be increased above the level of inflation only if prices for the other product receive increases that are below the level of inflation—a zero-sum game. Under this system, the only way cost coverage can be improved is by reducing costs. *Id.* To address this problem, the Postal Service would provide an additional 2 percent of rate authority for the entire Periodicals Class whenever the Postal Service seeks to raise rates for the class. *Id.* at 84-85. To be eligible for the additional 2 percent, the Postal Service would be required to use all available rate authority for the class—CPI authority, supplemental rate authority, performance-based rate authority, and banked rate authority. *Id.*

The Public Representative supports the Commission's goal of increasing revenue from non-compensatory products and classes. However, the Public Representative cannot support the mechanisms proposed by the Commission for achieving that goal. In Section III.C.3., above, the Public Representative discusses the reasons why he does not support the Commission's proposals.

With respect to the problem of non-compensatory products within compensatory classes, the Public Representative recommends the position advocated by Dr. Kwoka and Dr. Wilson. They urge that rates for these products be allowed to reset to compensatory levels as soon as possible. Kwoka/Wilson Decl. at 17. In his earlier declaration, Dr. Kwoka stated that this can be achieved by raising the non-compensatory product's rate within the overall cap. Kwoka Decl. at 27. He acknowledged that this would, of course, require rates for at least some other products within the class to be lowered. *Id.*

It was the requirement that rates for other products within the class be lowered that caused concern for the Postal Service. *See* Comments of the United States Postal Service, March 21, 2017, at 134-135. As stated by the Postal Service, its concern does not appear to be an opposition to raising non-compensatory rates *per se.* Rather, its concern is that in the circumstances in which it is being told to raise those rates, an increase in non-compensatory rates would result in the loss of revenues from other products, thereby perhaps reducing overall revenues from the class and exacerbating the Postal Service's losses. The Commission's targeted approach in Order No. 4258 seeks to avoid the problem identified by the Postal Service by creating another one, namely, by taking away the Postal Service's pricing prerogative.

The Public Representative submits that by adjusting the price cap for exogenous factors, as discussed above, rate authority for the compensatory class will make additional rate authority available to raise non-compensatory product prices. This additional rate authority will be based on established price cap principles and will foster increases in non-compensatory rates without infringing on the Postal Service's managerial prerogatives. If, notwithstanding this additional rate authority, the Postal Service chooses not to increase non-compensatory prices, an objection to that failure would, under current law, have to be raised by complaint.

With respect to the non-compensatory Periodicals Class, the Public Representative urges the Commission to raise the cap to permit the complete recovery of attributable costs. In their joint declaration, Dr. Kwoka and Dr. Wilson recommend this remedy "to prevent further harm to the Postal Service, and also to eliminate the economic inefficiency associated with below-cost pricing." Kwoka/Wilson Decl. at 17. When the PAEA was implemented in 2007, the hope was that these underwater products could be made profitable over time by cost cutting, efficiency improvements, and innovation. That hope proved to be misplaced. The non-compensatory prices for the Periodicals Class "have already damaged the Postal Service's operations and hampered any effort at putting it on firmer financial ground." Kwoka/Wilson Decl. at 17.

In Order No. 4258, the Commission limits the additional rate authority it proposes to give the Postal Service to 2 percent. Order No. 4258 at 85. It bases its decision on the assertion that this additional rate authority will "narrow the coverage gap [between revenues and costs] and move prices towards full cost coverage over time." *Id.* However, as Dr. Kwoka and Dr. Wilson point out, the Commission has provided no analysis of how long it would take to significantly increase cost coverage for the Periodicals Class using the additional 2 percent of rate authority proposed by the Commission. Kwoka/Wilson Decl. at 17.

Unless the Postal Service is given adequate authority to raise prices for the Periodicals Class, significant losses will continue. Under price cap theory, the cap for the Periodicals Class should have covered the Postal Service's costs at the time the price cap was implemented in 2007. *Id.* at 15. Under price cap theory, the cap should now be reset to correct this design deficiency. *Id.* at 17. There is nothing inherently wrong with expecting postal products, including Periodicals, to cover their costs. The Public Representative would not object to the Commission phasing-in an increase to the price cap for Periodicals provided the phase-in period is a period of 3-4 years similar to the phase-in period recommended for phasing-in price cap adjustment for exogenous cost recovery.

In his earlier comments, the Public Representative addressed possible concerns about an immediate reset of the Periodicals Class price cap to cover total costs. PR 2017 Comments at 57. The points made in those comments also apply to the phase-in of price cap adjustments for Periodicals. First, the adjustment of the price cap to cover Periodicals attributable costs would not relieve the Postal Service of the obligation to responsibly reduce costs and increase efficiency. *Id.* The Commission would continue to be able to explore operational reasons behind the failure to reduce costs. *Id.*

Second, the Postal Service would still be required to observe the statutory provisions that recognize the special place that Periodicals occupy. *E.g.,* 39 U.S.C. § 3622(c)(11) (recognizing ESCI value of certain mail classes and products); and 39 U.S.C. § 3626 (providing reduced rates for certain publications mailed within the county of their publication). And, the Commission would continue to exercise oversight of the Postal Service's pricing proposals. *Id.*

Third, raising the cap to completely cover Periodicals attributable costs would not, by itself raise prices for Periodicals. What it would do is give the Postal Service the opportunity to raise prices to cover costs.

Finally, if compelling reasons exist for the subsidization of Periodicals because of perceived societal benefits, the subsidization should, as it has in the past, come from taxpayers, not the Postal Service or other customers. PR 2017 Comments at 57.

D. Recommendation 4: Shorten Period Before the Next Review

In previous comments, the Public Representative recommended that a further review of the market dominant system be conducted not less than 4 years from the date changes to the price cap in this proceeding are implemented. PR 2017 Comments at 60-61. That recommendation was based upon Dr. Kwoka's Declaration. *Id.* In that declaration, Dr. Kwoka pointed out that periodic reviews of the performance of price cap systems are essential because not all problems with a price cap system can be anticipated. Kwoka Decl. at 9; Kwoka/Wilson Decl. at 4-5. Periodic reviews permit timely corrective action. Kwoka Decl. at 8-9*.*

Had an earlier review of the Postal Service's price cap system been conducted, it would have permitted earlier intervention to deal with the unanticipated volume declines, the pattern of RHB lump sum payment defaults that developed, and the strains that declining revenues placed on the Postal Service's service performance. Although timely reviews are an essential part of price cap regulation, Dr. Kwoka also cautioned that reviews that are conducted too frequently can cause price cap regulation to resemble cost-of-service regulation. *Id.* at 8.

In Order No. 4258, the Commission agreed with Dr. Kwoka that it is critical to revisit a price cap plan's performance quickly enough to take corrective action. Order No. 4258 at 37. However, the Commission decided not to accept Dr. Kwoka's recommendation that the next review be conducted in not less than 4 years. Instead, the Commission has proposed that the next review be conducted in 5 years. *Id.*

Dr. Kwoka and Dr. Wilson recommend that the period before the next price cap system review be shortened to 3 years. Kwoka/Wilson Decl. at 17-18. Dr. Kwoka's original recommendation was that the next review should begin in not less than 4 years. Kwoka Decl. at 29. That change is prompted by "fast moving changes in underlying conditions." Kwoka/Wilson Decl. at 18-19. Those conditions, discussed above, include continuing losses, mounting defaults of employee benefit payment obligagtions, the critical need for investment, and the possibility of legislation. The Postal Service has stated that over this period it will need adequate resources to provide for much needed investment and to prepare for contingencies.[42] The proposals offered by the Public

[42] 2017 Form 10-K at 36. It should be noted that if the next recession is of a more normal magnitude than the Great Recession, the Postal Service will not have recourse to an exigent rate increase.

Representative are intended to give the Postal Service relief that addresses short-term, medium-term, and long-term financial needs.

The Public Representative recognizes that legislative relief may become available in the not-to-distant future. House bill H.R. 756 is one such potential source of relief. There is, however, no guarantee that legislation will be enacted. Nor does anyone know when legislation will be enacted. Given these uncertainties, prompt Commission action is required. As part of that prompt action, the Commission should plan on conducting a review of the adjusted system in 3 years. Indeed, if legislation is enacted, the Commission may be called upon to review the system within 3 years in order to consider measures that ensure the system properly integrates changes made by the legislation.

VI. CONCLUSION

For the reasons given above, the Public Representative submits that the system for regulating rates and classes for market dominant products should be modified as recommended herein.

Respectfully submitted,

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